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NOTES AND MEMORANDA.

RECENT CHANGES IN THE TAXING LAWS OF MICHIGAN.

THE motive for the recent change in the system of taxation in Michigan is found in the desire to realize equality of taxation under the form of a general property tax. From the organization of the State to the present time, two distinct schemes of taxation have been kept in active administration: the one known as the "general tax," which was applied to all property not expressly exempted, the other known as the "specific tax," which provided for the taxation of railroad companies, river improvement companies, insurance companies, plank-road companies, and a few others expressly stated by law, in some manner arbitrarily determined by the legislature. This distinction is found in the Constitution itself, which imposes upon the legislature the duty of providing a uniform rate of taxation, except upon such properties as pay specific taxes. By a law passed by the last legislature, this dual system of taxation contemplated by the framers of the Constitution, and followed by all legislatures up to the present time, has been swept away. All property in Michigan is now to be taxed on the ad valorem basis.

Michigan has experimented with two methods in the administration of specific taxes. Prior to 1871 the railroads of Michigan, as also other important corporations, paid a specific tax on the basis of capital stock paid in. In 1871 gross earnings were substituted for the amount of stock paid in as the basis of taxation, and this continued to be the basis of payment up to the present time. Confining the statement to railroads, the rate of payment was not the same for all companies, but varied according to the gross earnings per mile of line. At the time the law was repealed by including railway property in the ad valorem system of taxation, the rates were as follows: —

	<i>Per cent.</i>
Upon gross earnings not exceeding \$2,000 per mile	2½
Upon excess of \$2,000 not exceeding \$4,000 "	3½
Upon excess of \$4,000 not exceeding \$6,000 "	4
Upon excess of \$6,000 not exceeding \$8,000 "	4½
Upon excess of \$8,000 per mile	5

In 1899 the railroads of Michigan paid to the State, under the operation of this law, \$1,091,556.39. The amount which they will contribute on the basis of valuation is not yet known.

The method of taxing corporations on the basis of gross earnings has been criticised from two points of view. In the first place, the fact that the proceeds of this tax go directly to the State treasury has given rise to a feeling on the part of the minor civil divisions that they are deprived of a considerable portion of the property which by right ought to be included in local assessments. This criticism, however, has never been strong in the State. Indeed, the amount contributed under the new law, by such corporations as paid specific taxes in 1900, goes to the State, and not to the localities; and the fact that most of the money thus collected is handed over to the localities for the support of the common schools must necessarily break the force of this criticism. The second criticism upon specific taxation of corporations is that corporations did not, under this plan, pay a rate upon the value of their property equal to the rate paid by other properties. It was conceded by all parties to its controversy that equity in taxation means equality of rate. This criticism it was which caused the abandonment of the tax.

The significant steps in the abandonment of the system of specific taxation are as follows: In 1899 the so-called Atkinson law was passed, which created a State Board of Assessors whose duty it was to assess the property of all railroads, express, telegraph, and telephone companies in the State, to determine the average rate of county and municipal taxes throughout the State, and to tax the property of the several companies as assessed at the average rate of taxation paid by other properties. It was especially provided that the franchises of corporations should be included in their assessed value. This law was never passed upon by the courts; but a test case upon the telephone tax law, which was similar to

the Atkinson law, showed this law to be unconstitutional "on the ground that, being a tax on property, based on assessment, it was not a specific tax, but an *ad valorem* or property tax, and was not within the uniform rule of taxation prescribed by the constitution of the State, for the reason that it was based upon the average rate of taxation throughout the State, and not the local rate applicable to other assessed property." This decision necessitated a change in the Constitution if the property of corporations was to be taxed on the basis of valuation at a uniform rate throughout the State. An amendment to the Constitution was accordingly prepared and submitted to the people at the general election November 6, 1900, with the result that the amendment received the approval of the people by a majority of 383,672 votes. This was the third time that the people expressed themselves in favor of a revision of the laws taxing corporations; and in the spring of 1901 a new law was passed, similar in its aims and provisions to the Atkinson bill. It is one of the anomalies of public life that Governor Pingree, to whom belongs the credit (if credit it be) of taxing railway properties on the basis of valuation, should not have been permitted to sign this bill, but that it should have been signed by his successor, Governor Bliss, who, to say the least, seemed indifferent to the success of the measure.

If corporations conducting an interstate business are to be taxed on the basis of the value of their property within the State, a great deal depends upon the method followed in ascertaining this valuation; and it may be worth while to say a word respecting the rule of valuation adopted in Michigan. The legislature of 1899 passed a law creating a Board of State Tax Commissioners for the better administration of the taxing laws of the State. Among the duties imposed upon this board was that of ascertaining the true value of properties paying specific taxes. The ostensible purpose of this valuation was to determine whether the properties imposed with specific taxes pay upon their true value a rate equal to the value of the property taxed under the general tax law; but the framers of this law well understood that the value thus ascertained would ultimately be used as the basis of taxation. The statement which

follows confines itself to railway properties. The first point decided by the commission was that the value of railway properties is both tangible and intangible, that is to say, the process of valuation necessitates the separate appraisal of the physical and of the non-physical elements. The theory adopted for the appraisal of the physical elements was the theory of reproduction and deterioration, thus reducing the problem, so far as physical valuation is concerned, to an engineering problem. Some of the best engineers of the State were employed by the board, and every property in the State was subjected to personal examination. The report of this body of engineers was not presented in the form of a lump sum for each road, but the value of each road was classified according to the official Classification of Construction Accounts prescribed by the Interstate Commerce Commission. In the final report one column of figures gives, item by item, the cost of constructing a new property. This is followed by a second column of figures which shows the present value of the property as it now stands, allowance being made for deterioration through use. This assessment of the physical valuation of the railways cost the State something in excess of \$40,000, but it is worth all that it cost; for the thoroughness with which the work was done, as also the high standing of the experts by whom the appraisal was made, has given to the State an assessment which commands universal confidence.

The value of the intangible elements of railways was arrived at from an investigation of their income account. The rule adopted, stated concisely, was as follows: To the gross earnings of a railroad was added the income derived by the corporation from corporate investments or from any sources other than operation. From this sum was deducted; first, operating expenses; and, second, 5 per cent. of the physical value of the railroad in question, as reported by the engineers, together with a few incidental payments that need not here be mentioned. In case gross earnings showed an excess over operating expenses and a 5 per cent. annuity on valuation, the remainder was capitalized at 7 per cent., which capitalization was regarded as the intangible value of the property. This valuation, added to the present value reported by the engineers, gave the true value of the property.

Any discussion of this rule would be out of place, but two remarks are necessary for its understanding. In the first place, it should be noted that the income account made the basis of this computation is the average income account for a series of years, and not the account of any particular year. This seemed necessary in order to avoid extreme fluctuations in value from year to year. It should be noted in the second place that in the 5 per cent. allowed on the physical valuation of the properties, and in the 7 per cent. used as the basis of capitalizing the final surplus, is included a 1 per cent. tax upon the valuation ascertained. In this manner, allowance was made for the effect of the tax encumbrance upon the valuation of the property; and the valuation arrived at could be placed immediately in comparison with the valuation of property paying the general property tax.

It may be of interest to state that the physical value of Michigan railways appraised in the manner described was found to be \$166,398,156; and the non-physical value of Michigan railways was found to be \$35,814,043, making an aggregate value of railways within the State of \$202,212,199. If this valuation be accepted as the basis of payment under the new law, it will result in a contribution from the railways two or three times greater than the amount which they contributed in 1899 in the form of a specific tax on their gross earnings. No definite statement can be made upon this point, however, at the present time; for the Board of Tax Commissioners has not yet declared what the "average rate" of taxation is at which railroad property is to be taxed.

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